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SENSITIVE

STATE FOR E, P, EUR AND EB
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SUBJECT: TURKEY'S ECONOMY MARCH 3/3 COB: MARKETS STABILIZE,
BUT DEBT FINANCING A CONCERN

REF: ANKARA 1351

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distribution.

Markets Stabilize in Afternoon Trading

[11.](#) (SBU) Turkish financial markets at COB March 3 stabilized
after a rough morning which saw relatively heavy capital
outflows:

-- The lira depreciated about 3 percent, closing at TL
1,651,000 to the dollar. The Central Bank markets department
reported a net capital outflow today of \$120 million, \$85
million from one bank.

-- The benchmark T-bills closed at 60 percent in annually
compounded terms, up 5.5 percentage points on the day, in
heavy trading volume of TL 830 trillion (about \$550 million).

-- The Istanbul Stock Exchange dropped 12.5 percent in
relatively heavy trading of TL 458 trillion (about \$300
million).

[12.](#) (SBU) Comment: As reported at mid-day (reftel), the
sell-offs were contained by two factors: first, PM Gul's
press statement on the budget, backed by the IMF Mission
Chief's supporting statement; second, a hope among some
investors that the U.S. package will soon become available,
because the parliament will pass a second troop deployment
resolution. As Lehman Bros analyst told us, "The bad news of
no U.S. package is not priced in. It would lead to a second
sell-off, with Eurobonds dropping another 4-5 percentage
points, and T-bill yields ending up at 65 percent or higher."

[13.](#) (SBU) Comment Continued: Looking ahead, the March 19
domestic debt redemption of TL 5.2 quadrillion (about \$3.5
billion) is a concern. The Treasury may well use up some of
its cash reserves of TL 4.2 quadrillion to take care of the
March 5 redemption, leaving less flexibility to take care of
the larger March 19 redemption. The "safety valve" may be
for Treasury to use moral suasion with the state banks
(especially Ziraat) to step up and buy more GOT debt. End
Comment.

IMF Resrep: Financing Gap a Concern

[14.](#) (SBU) IMF resrep told us March 3 that Fund staff are
reviewing the the financing assumptions behind the 2003
budget (basically, an average T-bill interest rate of 45
percent, 90 percent debt roll-over rate, 8 month average
maturity), which he noted do not take into consideration the
effect of an Iraq operation. Fund staff cannot recommend
their Board approve the Fourth Review, if the GOT faces a
funding gap in 2003, he stressed. Mission Chief Kahkonen's
March 3 press statement says the GOT draft budget achieves a
6.5 percent primary surplus, but it doesn't say this is
sufficient for the GOT's funding needs, he concluded.

February Inflation Data: Credibility of
Macro Framework May Be Questioned

15. (U) At market close March 3, the State Statistics
Institute released the February inflation data:

	February	January
Consumer Prices	2.3 pct	2.6 pct
Wholesale Prices	3.1 pct	5.6 pct

16. (SBU) Comment: The February inflation results are in line with market expectations, and seasonal adjustments (for higher food prices in winter) should reduce them. The government-controlled price increases of January affected February CPI, but this is not a lasting effect. Nevertheless, two straight months of high inflation may start to have a corrosive effect on market acceptance of the GOT's macro-economic framework. We're two months into the year and the aggregate WPI is nearly half of the year-end target. We will check the Central Bank's next inflation expectations survey (due out in mid-March) to see if expectations are affected.
PEARSON